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How to read relative strength and major sector stock patterns

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MODULE 1

• Main Points:

- Stocks in each major sector (telecom, internet, chips, boxmakers, retailers etc) tend to follow the "sector leaders".

Examples:



- **INTERNET** SECTOR LEADERS (\$GIN) : AOL YHOO AMZN DCLK
- **CHIP** SECTOR LEADERS (\$SOX): INTC AMAT XLNX
- **COMPUTER** SECTOR LEADERS: GTW DELL IBM SUNW AAPL
- **TELECOM** SECTOR LEADERS: T WCOM FON GTE

Note that sector index symbols vary by quote source (eg esignal, bigcharts and quotetracker may be different, etc.).

- **Learning how to identify intraday divergence between a particular stock in a sector and the sector leaders can prove very profitable.** If the whole sector is down, say internets, but one stock hasn't sold off with the rest of the sector, it's a solid candidate for being the first one to bounce up strong when the sector & market turn up (either intraday or across 2 or more days). We say its **intraday relative strength** is higher. Conversely, stocks that are not being bought as much as the sector leaders are in an uptrend (the "generals" of the army) will tend to sell off the fastest as soon as the market and sector head down.

Examples:

This is a picture of the \$GIN (Internet Index) for Tuesday, November 30th:



Except for our "10:30 bounce" (remember I told you about that pattern

earlier), the nets pretty much sold off all day. Notice please: \$GIN made a lower low towards the end of the session. The previous low was at 580, the new low at 573.

Pop Quiz: Which of the following net stocks have the 1) strongest and 2) weakest relative strength to the index? And, what price action would you be watching for during the remainder of the week in these specific stocks?



Hint: Remember we're looking at price action relative to the sector index, relative to the "generals" of the sector, as well as the buying strength and selling weakness.

What do these four charts, taken with the sector chart above, tell you you should keep an eye on to buy during the next trading day? Who's strong? Who's weak?

(Answers at bottom of page)

Answers:

Weakest charts are AOL and YHOO. (also made new lows on the day at the end of the day, lots of selling).



Strongest charts are ETYS, then AMZN. Notice that ETYS did not make a lower bottom, and AMZN only weakened slightly in comparison to the \$GIN and other 'net charts.

The trading play? Watch ETYS and AMZN for pre-market gap on the next trading day, and buy **if** the buying volume and higher highs/higher lows are being made on the tick chart. We could expect more selling before buyers come back, so wait to see volume buying and blocks going off in time & sales before entering a trade.

It's easy!

Remember, you just need to 'follow the buyers' and don't go against the sellers, for long plays. Common sense.

Notice please also that ETYS has the strongest run-up in the morning, meaning a lot of buyers were there for it. Another bullish signal for ETYS making a run again within the next few trading days.

Also, know your stocks' trading behavior, e.g., YHOO tends to gap up after being oversold on a close. So, I would have covered a YHOO short at the end of the day.

Traders, *do you understand why* there's a small 'hook upwards' at the end of the day for all four stocks? It's caused by mm's covering their shorts, which drives price up. That's another play, the "last-30-minute-ride-the-short-covers-up-on-a-down-day" action.

(note: we will cover volume and time-of-day patterns in another page)



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